

AMENDED IN SENATE AUGUST 7, 2006

AMENDED IN SENATE JUNE 20, 2006

AMENDED IN SENATE MAY 1, 2006

AMENDED IN ASSEMBLY APRIL 19, 2005

CALIFORNIA LEGISLATURE—2005–06 REGULAR SESSION

ASSEMBLY BILL

No. 675

**Introduced by Assembly Member Klehs
(Coauthors: Assembly Members Evans and Koretz)**

February 17, 2005

An act to add Section 19141.8 to the Revenue and Taxation Code, relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

AB 675, as amended, Klehs. Corporation taxes: study: book income.

The Corporation Tax Law imposes taxes according to, or measured by, net income.

This bill would make legislative findings and declarations regarding the manipulation of accounting rules and principles by certain corporations. This bill would require any corporation, including "S" corporations, subject to state income tax or any corporation included in a combined report to file, with its tax return, an information return, as specified, if the total assets of the corporation or the combined group equal or exceed \$10 million, and would impose specified penalties for failure to furnish the return, or filing a false or incomplete return, as provided.

This bill would require the Franchise Tax Board to report to the Legislature regarding book income and tax shelter activities, as specified.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. The Legislature finds and declares all of the
2 following:
- 3 (a) California has recently witnessed a growing and
4 well-publicized trend of corporations that manipulate accounting
5 rules and principles resulting in overstated earnings. The impact
6 on consumers or investors is inflated stock prices, ultimately
7 leading to investors that lose significant portions of their
8 investments, which is especially tragic when the lost investments
9 represent retirement savings.
- 10 (b) At the same time, there has been a growing and
11 well-publicized trend of corporations that invest in, or create,
12 abusive tax shelters through schemes and manipulation of tax
13 accounting rules that result in understated income to California.
- 14 (c) Studies have demonstrated a growing gap between taxable
15 income and reported book income, a gap that may generate
16 significant revenue losses to the state and that appears to result
17 from the growing use of tax shelters.
- 18 (d) During the spree of overstated earnings for financial
19 purposes and understated income for tax purposes, professional
20 organizations have failed to take proactive actions to curb
21 participation in these schemes and, even worse, have been
22 advocating questionable accounting practices by their own
23 members.
- 24 (e) Consumer confidence falls with the decline of corporate
25 accountability. Additional protection for consumers against
26 improperly inflated stock prices and protection for the citizens of
27 California against improperly reduced taxation may be achieved
28 by making certain corporations disclose the differences between
29 the income reported for tax purposes and the income used to
30 publicize earnings for financial, or Wall Street, purposes.
- 31 (f) Recently, the Internal Revenue Service instituted a program
32 to require corporations to complete, as part of the corporation tax

return, a comprehensive schedule that reconciles the difference between financial income (book income) and taxable income reported on its tax return. That expansive schedule is required if the corporation, or the combined reporting group of which the corporation is a member, reflects total assets of at least \$10 million.

(g) *In addition to the entities required to file an information return pursuant to Section 19141.8 of the Revenue and Taxation Code, as added by this act, the Franchise Tax Board may require information returns consisting of a reconciliation of financial net income (loss) to net income (loss) reported on a return required under Part 10.2 of the Revenue and Taxation Code (commencing with Section 18401) from any other entity required to file under that part.*

SEC. 2. Section 19141.8 is added to the Revenue and Taxation Code, to read:

19141.8. (a) (1) Any corporation subject to the tax imposed by Part 11 (commencing with Section 23001), and every corporation included in a combined report filed pursuant to Section 25106.5, shall file an information return providing the information described in subdivision (b) if the total assets of the corporation or the combined reporting group equal or exceed ten million dollars (\$10,000,000) as of the end of the taxable year. This subdivision only applies to a corporation whose stock is ~~commonly traded on a public stock exchange~~ *traded on a public stock exchange and, if that corporation is included in a combined report filed pursuant to Section 25106.5, every corporation included in that combined report.*

(2) *For purposes of this section, “a corporation whose stock is traded on a public stock exchange” means a corporation that is subject to the filing requirements of the United States Securities and Exchange Commission.*

(b) The information return required by this section shall consist of a reconciliation of financial statement net income (loss) to the net income (loss) reported on the tax return required under Part 10.2 (commencing with Section 18401) or a combined report required under this part for the taxpayer and each member of the combined report. The reconciliation required by this subdivision shall also include the distributive share of items from any unitary partnership.

~~(e) Any corporation that fails to furnish the information required under subdivision (a) shall pay a penalty of fifteen thousand dollars (\$15,000) for each failure, unless the failure is due to reasonable cause and not willful neglect.~~

(c) Any corporation that fails to make and file an information return required by subdivision (a) on or before the due date of the return as prescribed by Section 18601 shall pay a penalty of fifteen thousand dollars (\$15,000) for each failure, unless that failure is due to reasonable cause and not due to willful neglect.

(d) (1) Any corporation that files a false or incomplete information return required by subdivision (a) shall pay a penalty of fifty thousand dollars (\$50,000).

(2) If the Franchise Tax Board provides a corporation with notice that an information return is false or incomplete and the corporation corrects that information return within 60 days after the date of that notice, the penalty imposed under this subdivision shall not apply with respect to that information return.

(3) The Chief Counsel of the Franchise Tax Board may rescind all or any portion of any penalty imposed under this subdivision if both of the following apply:

(A) Imposing the penalty would be against equity and good conscience.

(B) Rescinding the penalty would promote compliance with the requirements of this part and Part 11 (commencing with Section 23001) and effective tax administration.

(4) The exercise of authority under paragraph (3) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(5) Notwithstanding any other law or rule of law, any determination under this subdivision shall not be reviewed in any administrative or judicial proceeding.

(e) The penalties imposed under subdivisions (c) and (d) are cumulative and the imposition of one penalty shall not be construed as a restriction on the imposition of the other penalty.

(f) This section shall apply to any return or combined report filed on or after January 1, 2007, and required to be filed on or before December 31, 2012. The Franchise Tax Board shall report to the Legislature, on or before December 1, 2011, with respect to the level of compliance and a discussion of the relative value of the information with respect to increasing accuracy in book

1 income reported and identifying participation of tax shelter
2 activities. The report shall describe the areas identified where
3 taxpayers reported significant differences between book income
4 and taxable income.

5 (g) The Franchise Tax Board may prescribe any regulations as
6 may be necessary or appropriate to carry out the purposes of this
7 section.

8 (h) Each penalty imposed under subdivisions (c) and (d) shall
9 be in addition to any other penalty provided by law.